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IN THE

Supreme Court of the United States

OCTOBER TERM 1962

No. 1000

RICHARD H. SHAFER and MARY ANN SHAFER,
Petitioners,

v.

UNITED STATES OF AMERICA,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

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UNITED STATES OF AMERICA,
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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

Petitioners pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Sixth Circuit entered in the above cause on January 11, 1963.

CITATION TO OPINIONS BELOW

The opinion of the District Court printed in Appendix hereto, *infra*, p. 1a, is reported in 204 F. Supp. 473. The memorandum opinion of the Court of Appeals, printed in Appendix hereto, *infra*, p. 7a, is reported in 312 F. 2d 747.

JURISDICTION

The judgment of the Court of Appeals was entered on January 11, 1963 (R. 21). The jurisdiction of this Court is invoked under 28 U. S. C. Section 1254 (1).

QUESTION PRESENTED

Whether defaulted coupons of defaulted pre-Second World War Japanese bonds, overstamped in 1952 with dates exactly ten years later than original, and required to be separated from the main obligation, and payable irrespective of the later call of the main obligation under a bondholder's settlement with the Japanese government in September 1952, became capital assets whose later sale permitted capital gains treatment of the proceeds.

STATUTES INVOLVED

Internal Revenue Code of 1939, U. S. C. Title 26.

Section 112(a)

Upon the sale or exchange of property the entire amount of the gain or loss, determined under Section 111, shall be recognized except as hereinafter provided in this section.

Section 117(a)(1) Capital Assets.

(As used in this Chapter) The term "capital assets" means property held by the taxpayer (whether or not connected with his trade or business). . . .

For purposes of this chapter. . . .

(4) Long Term Capital Gain. The term "long term capital gain" means gain from the sale or exchange of a capital asset held for more than eighteen months, if and to the extent such gain is taken into account in computing net income.

Internal Revenue Code of 1954, U. S. C. Title 26.

Section 1002

Except as otherwise provided in this subtitle, on the sale or exchange of property the entire amount of the

gain or loss, determined under section 1001, shall be recognized.

Section 1221.

For purposes of this subtitle, the terms "capital asset" means property held by the taxpayer (whether or not connected with his trade or business). . . .

Section 1222.

For purposes of this subtitle . . . (3) Long-term capital gain. The term "long-term capital gain" means gain from the sale or exchange of a capital asset held for more than six months, if and to the extent such gain is taken into account in computing gross income.

STATEMENT

The Stipulation of Facts was as follows (R. 15):

"It is hereby stipulated that for the purposes of this action the following statements shall be accepted as the facts of this case, without prejudice to the right of either party to object thereto on the grounds of relevancy or materiality or to introduce other and further evidence not inconsistent therewith:

"1. This Court has jurisdiction of this action under the provisions of Section 1346(a)(1), Title 28, United States Code.

"2. The plaintiffs were, and are now, citizens of the State of Ohio, residing at 6720 Lee Road, Westerville, Ohio, in the County of Franklin, Ohio.

"3. (a) Prior to the year 1941, plaintiffs purchased 6% Oriental Development Company Ltd. bonds due March 15, 1953 in a face amount of $44,000, and 6½% Imperial Japanese Government External Loan Bonds due February 1, 1954 in a face amount of $16,000. Both such bonds had semiannual interest coupons attached.

"(b) Due to the state of war existing between the United States of America and the Japanese Government,

service on these bonds was suspended on December 8, 1941. On December 11, 1941, the Securities and Exchange Commission advised stock and bond exchanges and dealers throughout the United States to cease handling all transactions in Japanese bonds, which included those set out above held by the plaintiffs.

"(c) By release No. 4518, dated November 11, 1950, the Securities and Exchange Commission removed the restrictions on trading Japanese Bonds. On December 22, 1952 the Japanese Government resumed service on the bonds to those holders who accepted a proposed settlement whereby the maturity date of the bonds and the payment date of each interest coupon bearing an original payment date prior to September 26, 1952, was extended for a period of 10 years from the original payment date, except that interest due prior to December 1942 was payable on December 22, 1952. The plaintiffs agreed to this settlement proposal with respect to these bonds.

"(d) The New York Stock Exchange then ruled that blocks of coupons (originally consisting of 20 coupons for the period 1942 to 1952, but under the terms of the offer, due from 1952 to 1962) could be detached from the bonds and sold in transactions apart from the purchase and sale of the bonds themselves.

"4. In the year 1954 plaintiffs sold coupons on these bonds bearing thereon restamped due dates subsequent to 1954 through Bache & Co., a member of the New York Stock Exchange, in the open market to unknown purchasers, receiving therefor $18,336. In addition, plaintiffs received interest of $8,677.44 on the current (due in 1954) coupons on these bonds.

"5. On their timely filed joint 1954 federal income tax returns, plaintiffs reported as long term capital gain an amount of $18,336 for 'Coupons past due Gov't bonds,' and reported ordinary interest income in the amount of

$8,157.44 for 'Oriental and Japanese Bonds—Current,' and in the further amount of $520.00 for 'Bache & Co.—Interest Japanese Bonds.'

"6. This 1954 return was audited by agents of the Commissioner of Internal Revenue, and a deficiency in tax was determined based upon the Commissioner's determination that the amount of $18,336 received from Bache & Co. for the sale of the block of post-1954 coupons (referred to in paragraph 4 above) was ordinary income rather than long-term capital gain as reported, as well as certain other adjustments to income not here in issue. The deficiency so determined in the amount of $14,126.50, plus interest of $2,999.07, or a total of $17,125.57, was timely assessed, and satisfied by plaintiffs by payments in the amount of $14,126.50 on October 29, 1958, and $2,999.07 on November 18, 1958.

"7. On September 2, 1959, plaintiffs timely filed a claim for refund in the amount of $12,101.76, on the ground that the amount of $18,336 received for the sale of the block of post-1954 coupons, as set out above, qualified for long-term capital gain treatment. By registered notice dated April 25, 1960, the Commissioner rejected this claim, and this suit for refund was timely commenced.

"8. If the Court should decide that this amount of $18,336 qualified for long-term capital gain treatment, there will be a joint computation by the parties of the appropriate refund amount, with submission to the Court if there should be a dispute as to this amount."

In addition to the agreed Statement of Facts, the Court will find in Revenue Ruling 54 in 1953-1 Cum. Bulletin p. 204, referred to by the District Judge in his opinion, a paragraph which discusses these bonds. The paragraph quoted in that opinion, CB 1953-1, p. 205, is as follows:

> "For the extended periods after original maturity dates, the bonds shall bear interest at the same rate

and with the same semi-annual payment dates of each extended year as specified in the original contracts and or indentures. The Japanese Government will endeavor to arrange that, about 1 month prior to the first semi-annual interest payment date in the first such extended year, or as soon as possible in the case of bonds already matured, new coupon sheets corresponding to such extended periods shall be attached to the respective bonds. In case where new coupon sheets are not ready by the date of actual payment, scrip or other certificates may be delivered so as to serve the purpose of the interest payment."

The next relevant paragraph therein, CB 1953-1, pp. 205-206, is as follows:

"The coupons bearing payment dates prior to December 22, 1942, shall be payable on December 22, 1952. The payment dates of the coupons bearing payment dates on or after December 22, 1942, and prior to September 26, 1952, shall be extended in each case for the exact period of ten years, and payment shall be made on the new dates. *Coupons overprinted with new payment dates shall be detached from the bonds* so that such bonds may be transferred or delivered separate and apart from such coupons, scrip, or other certificates so overprinted with new payment dates. *Such coupons, scrip, or other certificates, so overprinted with new payment dates shall continue to be payable on the new payment dates overprinted thereon, notwithstanding the prior maturity, or redemption of the bonds to which they originally appertained, and the accrued interest represented thereby will not be deemed to be 'accrued interest' for the purpose of determining the redemption price of bonds or the maximum price at which bonds may be purchased with moneys in a sinking fund therefor.*" (Emphasis by Counsel.)

It will also be noted in this last quotation that the bonds were callable.

REASONS FOR GRANTING THE WRIT

The nub of the opinion of the District Court was that,

"The interest coupons in question represented rights to interest income which they [Petitioners] had purchased in that form. This is not a situation where the plaintiffs made their original investment in detached interest coupons. . . ." (*Infra*, p. 5a.)

". . . Was there an exchange of a capital asset? No. Was there an extension of time for payment? Yes. The sole effect of the offer of settlement of the Japanese Government was a ten-year extension of the maturity or due dates of the bonds or coupons and the terms of the obligation were not otherwise altered." (*Infra*, p. 6a.)

This was held therefore not to be a sale or exchange upon which gain or loss must be recognized.

But the District Court made one serious error, which was not identified by the Court of Appeals. Both Courts (and counsel below, too) failed to note that while the settlement agreement of 1952 did not alter the terms of the original loan as to the bonds themselves except to extend the time, *it did alter the terms as to the coupons.*

The coupons and the bonds are separate obligations, as Chief Justice Stone pointed out in *Helvering* v. *Horst* (1940), 311 U. S. 112.

Obviously the original call provision referred to in CB 1953-1, p. 206, provided for the termination of interest on the date for which a bond was called. But in the settlement agreement it was provided that even if the bonds were called in less than 10 years, the extended coupons should each continue in effect to the overstamped date of payment.

It was for *this* reason that the settlement agreement provided that the coupons *must* be detached and dealt in separately. They were no longer subject to being wiped out by a call and redemption of the principal obligation, but

were independent obligations and no longer payable only as part of the main obligation.

Since the District Court did not grasp this point, it completely misinterpreted the action of the New York Stock Exchange. It failed to note that the blocks of coupons *had to be detached* under the settlement agreement. The District Court said:

> "The New York Stock Exchange ruling that blocks of coupons could be detached from the bonds and sold in transactions apart from the purchase and sale of these bonds themselves was for the benefit of bondholders who wished to realize their interest money without further extension of payment dates at a price which provided for the realization of accelerated income. . . . Plaintiffs did not receive new securities and the only act was the overstamping with new dates for payment of the existing bonds or coupons." (*Infra*, p. 5a.)

On the contrary the obligation of the Japanese Government as to the coupons *was* altered. The New York Stock Exchange ruling was *not* "for the benefit of bondholders who wished to realize their interest money," but was a necessary step to carry out the settlement agreement, and was issued because the coupon blocks were a new and different security.

This particular provision was a most important feature of the settlement agreement. The Japanese Government was refusing to pay any of the interest payments between 1942 and 1952. But for any reason, such as an improvement in their credit rating, and consequent reduction at a later date in the interest rates they must pay, it might profit them to call all or a part of these bonds. Then the holders of the coupon blocks might conceivably get back the equivalent of some of the wartime and post-war interest otherwise not payable in the settlement.

This element was clearly something that could make the coupon block worth more than the discounted value of the future income on the bond, and it constituted "a particularly valuable characteristic" of the block of coupons which makes them wholly distinguishable from the right to receive interest on the principal obligation. In fact, any future payments on coupons after the principal obligation had been redeemed, would not be "income" at all on anything, but some kind of a fortuitous bonus, a "sweetener" attached to the settlement of 1952. See the discussion of the "valuable characteristic" in the Court's opinion in *Langston* (1962 C. A. 5), 308 F. 2d 727, 732, and in the dissenting opinion p. 733. These "valuable characteristic" coupons were not acquired as a tax gimmick. The petitioners were straightforward investors all the way through.

This block of coupons then, when overstamped and returned, were property quite distinct from an ordinary block of detached coupons from a good bond, payable in the future and discounted to the present. *Helvering* v. *Horst* (1940), 311 U. S. 112, and see *Helvering* v. *Hort* (1941), 313 U. S. 28.

However illogical the rule may be that distinguishes them, this is not a block of defaulted coupons, bought separately, and when paid, properly deducted from cost as a return on capital. *Langston* (1962, C. A. 5), 308 F. 2d 729; *McDonald* (1954 C. A. 6), 217 F. 2d 475; *Pierce Corp.* (1941 C. A. 5), 120 F. 2d 206.

What were the petitioner' defaulted coupons prior to the September 26, 1952 agreement and petitioners adherence to it? If they had sold the whole collection "flat," bonds and coupons, the purchaser had a capital asset under the cases just cited. If the petitioners had sold them, and repurchased them after a proper interval or purchased other Japanese bonds in a similar amount, the petitioners had a capital asset. Why did not this process by which they

exchanged a block of defaulted coupons, whatever they were, for a new and different security, place them in the position of the owner of a capital asset, just as much as the other process did for Langston?

We submit that it did.

They were therefore entirely justified in returning the entire sale price as a capital gain in the year of sale.

Counsel is quite conscious that the Supreme Court in deciding whether a case is "certworthy," is not called upon to give the defeated party another hearing (*Magnum* v. *Coty* (1923), 262 U. S. 159, 163). We recognize that the Supreme Court is not, and never has been, primarily concerned with the correction of errors in lower Court decisions (Stern & Gressman, *Supreme Court Practise* (3d Ed.) 120).

The matters raised by this petition perhaps could have been effectively raised in a motion for rehearing in the Court of Appeals, but counsel, preparing this petition, was not employed in time for that.

We do submit, however, that the status of these blocks of coupons is a matter of very wide concern in the financial community. The original issues listed in 1953-1 CB 204 totalled over $468,000,000, and those bonds, including its own, whose payment was assumed by the postwar Japanese Government in 1952, totalled $76,460,000. The coupons on these bonds all had to be separated from the bonds themselves and were in fact dealt with as a separate issue. An erroneous legal status of these coupons should not be established merely by a District Court opinion, affirmed in the Court of Appeals; and more especially it should not be given prestige by denial of certiorari.

The Supreme Court may not be *primarily* concerned with the correction of errors in lower Court decisions. But it has some concern even for that, and is surely much concerned that justice be done in a case affecting conceivably more than 75,000 blocks of similar coupons.

CONCLUSION

We, therefore, urge that this petition for a writ of certiorari be granted, and the cause reversed by memorandum opinion for the reasons stated in this petition.

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APPENDIX

Opinion and Judgment of the District Court (204 F. Supp. 473) Civil Case No. 5860.

AGREED FINDINGS OF FACT

1. This Court has jurisdiction of this action under the provisions of Section 1346(a)(1), Title 28, United States Code.

2. The plaintiffs were, and are now, citizens of the State of Ohio, residing at 6720 Lee Road, Westerville, Ohio, in the County of Franklin, Ohio.

3. (a) Prior to the year 1942, plaintiffs purchased 6% Oriental Development Company Ltd. bonds due March 15, 1953 in the face amount of $44,000.00, and 6½% Imperial Japanese Government External Loan Bonds due February 1, 1954 in the face amount of $16,000.00. Both such bonds had semi-annual interest coupons attached.

(b) Due to the state of war existing between the United States of America and the Japanese Government, service on these bonds was suspended on December 8, 1941. On December 11, 1941, the Securities and Exchange Commission advised stock and bond exchanges and dealers throughout the United States to cease handling all transactions in Japanese bonds, which included those set out above held by the plaintiffs.

(c) By release No. 4518, dated November 11, 1950, the Securities and Exchange Commission removed the restrictions on trading Japanese bonds. On December 22, 1952, the Japanese Government resumed service on the bonds to those holders who accepted a proposed settlement whereby the maturity date of the bonds and the payment date of each interest coupon bearing an original payment

date prior to September 26, 1952, was extended for a period of ten years from the original payment date, except that interest due prior to December 1942 was payable on December 22, 1952. The plaintiffs agreed to this settlement proposal with respect to these bonds.

(d) The New York Stock Exchange then ruled that blocks of coupons (originally consisting of 20 coupons for the period of 1942 to 1952, but under the terms of the offer, due from 1952 to 1962) could be detached from the bonds and sold in transactions apart from the purchase and sale of the bonds themselves.

4. In the year 1954, plaintiffs sold coupons on these bonds bearing restamped due dates subsequent to 1954 through Bache & Co., a member of the New York Stock Exchange, in the open market to unknown purchasers, receiving therefor $18,336.00. In addition, plaintiffs received interest of $8,677.44 on the current (due in 1954) coupons on these bonds.

5. On their timely filed joint 1954 federal income tax return, plaintiffs reported as long term capital gain an amount of $18,336.00 for "coupons past due Gov't bonds" and reported ordinary interest income in the amount of $8,157.44 for "oriental and Japanese Bonds—Current," and in the further amount of $520.00 for "Bache & Co.—Interest Japanese Bonds."

6. This 1954 return was audited by agents of the Commissioner of Internal Revenue, and a deficiency in tax was determined based upon the Commissioner's determination that the amount of $18,336.00 received from Bache & Co. for the sale of the block of post 1954 coupons (referred to in paragraph 4, page 3) was ordinary income rather than long-term capital gain as reported as well as certain other adjustments to income not here in issue. The deficiency

so determined in the amount of $14,126.50, plus interest of $2,999.07, or a total of $17,125.57, was timely assessed, and satisfied by plaintiffs by payments in the amount of $14,126.50 on October 29, 1958, and $2,999.07 on November 18, 1958.

7. On September 2, 1959, plaintiffs timely filed a claim for refund in the amount of $12,101.76, on the ground that the amount of $18,336.00 received for the sale of the block of post 1954 coupons, as set out above, qualified for long-term capital gain treatment. By registered notice dated April 26, 1960, the Commissioner rejected this claim, and this suit for refund was timely commenced.

The issue before this Court as presented by the plaintiffs is: Did the original interest coupons attached to the Japanese war bonds become converted to capital assets during the war period in which they were valueless and nonnegotiable so that when they were traded in for new overstamped coupons in 1952, the transaction constituted a sale or exchange of capital assets under Section 112 of the Internal Revenue Code of 1939?

The stipulation of facts is not clear as to whether or not plaintiffs received new overstamped coupons in 1952. Reference is made however to a paragraph in the Commissioner's Report. Rev. Rul. 54, 53-CB-1 (1953) [Revenue Ruling 54 Cum. Bull. 1953-1, pp. 204, 205].

> "For the extended periods after original maturity dates, the bonds shall bear interest at the same rate and with the same semi-annual payment dates of each extended year as specified in the original contracts and/or indentures. The Japanese Government will endeavor to arrange that, about 1 month prior to the first semi-annual interest payment date in the first such extended year, or as soon as possible in the case

of bonds already matured, new coupon sheets corresponding to such extended periods shall be attached to the respective bonds. In cases where new coupon sheets are not ready by the date of actual payment, scrip or other certificates may be delivered so as to serve the purpose of the interest payment."

The Court does not believe that the issuance of new coupons or the overstamping of old coupons is a factual question which can change the question of law herein presented.

The question to be primarily determined by the Court is as follows: Do the proceeds from the sale of the coupons qualify as long term capital gain or were said proceeds properly taxed by the Commissioner as ordinary income?

DISCUSSION

This being a case of first impression with the Courts, we first note the arguments advanced by plaintiffs. In summary, plaintiffs set forth—(1) that they did not have any use or benefit from the coupons due to circumstances entirely beyond their control during the Japanese War Period; (2) that they could not legally collect on the coupons due to the Trading With The Enemy; and (3) that they acted in good faith at every stage of the transaction.

Ordinary income cannot be converted into capital gain by such reasoning. One cannot change the status of interest bearing coupons because of the lack of use or benefit thereof or uncollectibility for a period of time or because of good faith. A capital gain can only result from a sale or exchange of a capital asset. The advice of the Securities and Exchange Commission suspending service on these bonds on December 8, 1941, was a restriction on trading with a result that there was no market for the bonds in the United States, and therefore, no quotations on the bonds.

All individuals owning securities of a foreign country who purchase and retain bonds of said foreign country do so with full knowledge that there will be no market, no quotations and no value for said securities during the period of time that the United States is at war with said country. It follows, too, that said securities during said period of time would be uncollectible. Such a risk is self evident and plaintiffs cannot thus complain and present the argument of good faith because of the restrictions imposed as a result of war.

Plaintiffs claim that equity merits consideration under such circumstances. The Court believes that the plaintiffs must rely solely upon the transaction imposed by the Japanese Government wherein service on the bonds was resumed to those holders who accepted a proposed settlement whereby the maturity date of the bonds and the payment date of each interest coupon bearing an original payment date prior to September 26, 1952, was extended for a period of ten (10) years from the original payment date. The interest coupons in question represented rights to interest income which they had purchased in that form. This is not a situation wherein the plaintiffs made their original investment in detached interest coupons.

The New York Stock Exchange ruling that blocks of coupons (for the period of 1942 to 1952) could be detached from the bonds and sold in transactions apart from the purchase and sale of these bonds themselves was for the benefit of bondholders who wished to realize their interest money without further extension of payment dates at a price which provided for the realization of accelerated income. Such sale was voluntary and did not change the character of the transaction. Plaintiffs did not receive new securities and the only act was the overstamping with new

day for payment the existing bonds and coupons, or the substitution of new coupons. It was not necessary for plaintiffs to accept the proposed settlement which extended the payment date of each interest coupon and the maturity date of the bonds. The offer of settlement did not affect the existing rights of holders of bonds or coupons who did not accept the offer. Therefore, non acceptance of the proposed settlement did not invalidate the securities.

Was there a sale? No. Was there an exchange of a capital asset? No. Was there an extension of time for payment? Yes. The sole effect of the offer of settlement of the Japanese Government was a ten year extension of the maturity or due dates of the bonds or coupons and the terms of the obligation were not otherwise altered. It is settled that an agreement extending the maturity dates or notes does not produce a sale or exchange upon which gain or loss must be recognized. See *Motor Products Corp.* v. *Commissioner*, 47 B. T. A. 983 (First Issue), affirmed *per curiam* on the opinion, 142 F. 2d 449 (C. A. 6th).

The Court agrees with the ruling of the Commissioner after considering these same facts (Rev. Rul. 54, 1953-1 Cum. Bull. 204) holding that acceptance of the offer of settlement and presentment of the bonds to the Japanese Government for the purpose of overprinting the extended maturity date thereon, pursuant to the offer of settlement, does not constitute an exchange of property which results in gain or loss recognizable under Section 112 of the Code.

JUDGMENT

It is therefore concluded that the proceeds from the sale of the coupons do not qualify as long term capital gain and were properly taxed by the Commissioner as ordinary income. Judgment is therefore granted in favor of defend-

ant, United States of America and against plaintiffs, and the complaint filed by plaintiffs is hereby dismissed.

No special entry necessary.

s/ CARL A. WEINMAN
Judge, U. S. District Court

Opinion and Judgment of the Court of Appeals (312 F. 2d 747). Case No. 14942.

ORDER

This cause came on to be heard upon briefs, oral arguments of counsel, and the full record in the case. On consideration whereof:

It is Ordered and Adjudged that the judgment of the District Court for the Southern District of Ohio be and it is hereby affirmed for the reasons stated in its opinion, reported in 204 F. Supp. 473.[1]

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[1] See *First Kentucky Co.* v. *Gray*, 309 F. 2d 845 (C. A. 6), Nov. 21, 1962.

day for payment the existing bonds and coupons, or the substitution of new coupons. It was not necessary for plaintiffs to accept the proposed settlement which extended the payment date of each interest coupon and the maturity date of the bonds. The offer of settlement did not affect the existing rights of holders of bonds or coupons who did not accept the offer. Therefore, non acceptance of the proposed settlement did not invalidate the securities.

Was there a sale? No. Was there an exchange of a capital asset? No. Was there an extension of time for payment? Yes. The sole effect of the offer of settlement of the Japanese Government was a ten year extension of the maturity or due dates of the bonds or coupons and the terms of the obligation were not otherwise altered. It is settled that an agreement extending the maturity dates or notes does not produce a sale or exchange upon which gain or loss must be recognized. See *Motor Products Corp.* v. *Commissioner*, 47 B. T. A. 983 (First Issue), affirmed *per curiam* on the opinion, 142 F. 2d 449 (C. A. 6th).

The Court agrees with the ruling of the Commissioner after considering these same facts (Rev. Rul. 54, 1953-1 Cum. Bull. 204) holding that acceptance of the offer of settlement and presentment of the bonds to the Japanese Government for the purpose of overprinting the extended maturity date thereon, pursuant to the offer of settlement, does not constitute an exchange of property which results in gain or loss recognizable under Section 112 of the Code.

JUDGMENT

It is therefore concluded that the proceeds from the sale of the coupons do not qualify as long term capital gain and were properly taxed by the Commissioner as ordinary income. Judgment is therefore granted in favor of defend-

ant, United States of America and against plaintiffs, and the complaint filed by plaintiffs is hereby dismissed.

No special entry necessary.

s/ CARL A. WEINMAN
Judge, U. S. District Court

Opinion and Judgment of the Court of Appeals (312 F. 2d 747). Case No. 14912.

ORDER

This cause came on to be heard upon briefs, oral arguments of counsel, and the full record in the case. On consideration whereof:

It is Ordered and Adjudged that the judgment of the District Court for the Southern District of Ohio be and it is hereby affirmed for the reasons stated in its opinion, reported in 204 F. Supp. 473.[1]

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[1] See *First Kentucky Co.* v. *Gray*, 309 F. 2d 845 (C. A. 6), Nov. 21, 1962.

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No. 1040

[redacted]

In the Supreme Court of the United States

OCTOBER TERM, 1962

No. 1000

RICHARD H. SHAFER AND MARY ANN SHAFER,
PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

The question presented is whether amounts received by taxpayers from the sale of interest coupons detached from Japanese Government bonds were taxable as ordinary income or as capital gain. The bonds, acquired by taxpayers prior to 1942, were originally due to mature in 1953 and 1954, and bore attached semi-annual interest coupons. With the advent of World War II, the Japanese Government suspended service on the bonds. In December 1952, however, it resumed service to those holders who accepted a proposed settlement whereby the maturity date of the bonds and the payment date of each interest coupon bearing an original payment date prior to September 26, 1952, were extended for a period of ten years from the original payment date (except that in-

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terest due prior to December 1942 was payable on December 22, 1952). The taxpayers agreed to this settlement proposal. The New York Stock Exchange then ruled that blocks of coupons—each consisting of twenty coupons, originally due on dates from 1942 to 1952, but, under the terms of the agreement, due on dates from 1952 to 1962—could be detached from the bonds and sold in transactions apart from the purchase and sale of the bonds themselves. In 1954, taxpayers, through a broker on the New York Stock Exchange, sold coupons bearing restamped due dates subsequent to 1954 (Pet. App. 1a–2a). The district court upheld the Commissioner's determination that the proceeds were ordinary income, and the court of appeals affirmed.

This case is governed by the well-established rule that proceeds from the sale of bond coupons, representing a right to interest which has accrued during the period of the vendor's ownership of the bonds, are taxable as ordinary income.[1] That rule, in turn, is but a special application of the general principle that a taxpayer may not convert ordinary income into capital gain by an anticipatory assignment of the right to that income. See, *e.g.*, *Commissioner* v. *P. G. Lake, Inc.*, 356 U.S. 260; *Hort* v. *Commissioner*, 313

[1] *First Kentucky Co.* v. *Gray*, 309 F. 2d 845 (C.A. 6th); *United States* v. *Langston*, 308 F. 2d 729 (C.A. 5th); *Jaglom* v. *Commissioner*, 303 F. 2d 847 (C.A. 2d); *Fisher* v. *Commissioner*, 209 F. 2d 513 (C.A. 6th), certiorari denied, 347 U.S. 1014. These cases hold that upon the sale of bonds purchased flat (*i.e.*, without allocation of purchase price between principal and interest), the vendor realizes ordinary income to the extent that the sales price is allocable to interest accrued on the bonds subsequent to their acquisition by the vendor.

U.S. 28; *Helvering* v. *Horst*, 311 U.S. 112; *Commissioner* v. *Phillips*, 275 F. 2d 33 (C.A. 4th); *Tunnell* v. *United States*, 259 F. 2d 916 (C.A. 3d); *United States* v. *Snow*, 223 F. 2d 103 (C.A. 9th), certiorari denied, 350 U.S. 831; *Rhodes' Estate* v. *Commissioner*, 131 F. 2d 50 (C.A. 6th); *Arnfeld* v. *United States*, 163 F. Supp. 865 (C. Cls.).

To avoid the force of this precept, taxpayers argue that the 1952 settlement agreement with the Japanese Government involved the exchange of the original defaulted coupons for new coupons constituting a new and entirely different security, and that the latter, unlike the former, were capital assets in the taxpayers' hands. This contention was properly rejected by the district court, which ruled, as had the Commissioner in an earlier revenue ruling (Rev. Rul. 54, 1953—1 Cum. Bull. 204), that the acceptance of the offer of settlement and the presentment of the bonds to the Japanese Government for the purpose of overprinting the extended maturity date did not amount to an exchange of property requiring recognition of gain or loss under Section 112 of the 1939 Code. In so holding, the court noted that the sole effect of the settlement was a ten-year extension of the maturity or due dates of the bonds or coupons, and that the terms of the obligation were not otherwise altered. This conclusion, we submit, is not weakened, but greatly fortified, by the provision of the settlement agreement—upon which taxpayers heavily rely—that the extended coupons would continue to be payable nothwithstanding the prior maturity or redemption of the bonds themselves. For the effect of that provision

was to make certain that the interest obligations represented by the defaulted coupons—obligations which by 1952 had become fixed and unconditional—would retain that character despite the postponement of the payment date, and would not be replaced by purely contingent obligations which could be wiped out by the premature redemption of the bonds. In short, although the provision in question did modify the terms of the coupons as originally drafted prior to 1942, the practical effect of the change was to make the extended coupons which the taxpayers received in 1952 equivalent in all respects (except due date) to the defaulted coupons, embodying fixed rights, which they surrendered.

Furthermore, assuming *arguendo* that there was a taxable exchange in 1952, it still would not follow that the extended coupons were capital assets. On that assumption, the overstamped coupons attached to the new bonds would represent rights to future interest accruing during the period 1952–1962, instead of rights to interest already accrued during the period 1942–1952. In the former case, no less than the latter, the detachment and sale of the coupons would yield ordinary income, not capital gain. The coupons do not lose their character as "interest" merely because they continue to be payable even if the bonds themselves are prematurely called. Otherwise, the issuer of bonds need only make the coupons payable in all events to convert them into capital assets and to transform the periodic interest payments

into return of capital. See *Langston, supra; McDonald* v. *Commissioner,* 217 F. 2d 475 (C.A. 6th).

Respectfully submitted.

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